NEW JERSEY DIVISION OF TAXATION
TECHNICAL BULLETIN

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FOR RELEASE: **INTERNAL ONLY ________** **ISSUED: 3-3-03**
OUTSIDE DIVISION ___x__

TAX: **GROSS INCOME TAX**

TOPIC: **CAFETERIA PLANS**

The New Jersey gross income tax law does not adopt the federal income tax treatment of cafeteria plans as provided under I.R.C. Section 125. However, the New Jersey gross income tax law has a very limited exclusion for one particular type of cafeteria plan, not including any salary-reduction plan. ***Since the New Jersey exclusion is very limited, the value of cafeteria plan benefits typically is includable in New Jersey taxable wages and subject to gross income tax withholding.****

Under N.J.S.A. 54A:6-24, the value of a cafeteria plan benefit is excludable from New Jersey gross income if all of the following qualifications are met:

1) the value is excludable for federal income tax purposes and the plan meets the requirements of I.R.C. Section 125;

2) the option to receive cash, instead of a federally-excludable cafeteria plan benefit, is conditioned on the employee having a similar benefit from another source;

3) the cafeteria plan benefit is **not** provided pursuant to a salary reduction agreement or an agreement to forgo increases in compensation, including (but not limited to) agreements commonly known as flexible spending accounts or premium conversion options; and

4) the employee elects to receive the cafeteria plan benefit, instead of cash.

EXAMPLES:

1) A Section 125 cafeteria plan allows employees to receive a health insurance benefit if the employee agrees to reduce his or her annual salary by $2,400. Sue chooses to receive the benefit by agreeing to the reduction. For New Jersey gross income tax

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*The gross income tax treatment of contributions to a qualified I.R.C. Section 401(k) plan (not including the Federal Thrift Savings Plan) follows the federal treatment, including when they are made through a cafeteria plan. N.J.S.A. 54A:6-21.

purposes, Sue's full salary, without the reduction, is subject to tax and withholding. The cafeteria plan benefit cannot meet the New Jersey requirements for excludability because the benefit is provided pursuant to a salary reduction agreement.

2) A Section 125 cafeteria plan includes a flexible spending arrangement (FSA) under which an employee may agree to have up to $2,000 a year deducted from his or her salary for medical expenses reimbursement. Bob agrees to have $2,000 deducted from his salary for the FSA. For New Jersey gross income tax purposes, Bob's full salary, without reduction, is subject to tax and withholding. The FSA benefit cannot meet the New Jersey requirements for excludability because it is provided pursuant to a salary reduction agreement.

3) A Section 125 cafeteria plan offers employees $2,400 a year, as a supplement to regular salary, to use for a health insurance benefit or to receive in cash. Harry chooses to receive the health insurance benefit. For New Jersey gross income tax purposes, Harry is subject to tax and withholding on the $2,400 amount. The benefit does not meet the New Jersey requirements for excludability, because the option to receive cash is not conditioned on the employee deriving a similar benefit from another source.

4) Assume the same facts as in example 3, except the plan includes a provision under which employees are allowed to receive the cash supplement **only if the employee derives a similar health insurance benefit from another source**. Although Harry has similar health insurance coverage through his wife's employer, Harry prefers the coverage provided under his employer's plan and elects to receive the health insurance benefit provided by his employer. The $2,400 value is excludable from Harry's gross income for New Jersey gross income tax purposes. (If the example is changed so that Harry selects the cash option, the cash amount would be includable in his wages subject to tax and withholding.)